BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Gregory Scott	Chair
Edward A. Garvey	Commissioner
Marshall Johnson	Commissioner
LeRoy Koppendrayer	Commissioner
Phyllis A. Reha	Commissioner

In the Matter of a Petition to Eliminate Transfer Payments from the Existing EAS Rates in the Montrose and Waverly Exchanges

ISSUE DATE: October 24, 2001

DOCKET NO. P-413/M-01-500

ORDER APPROVING RATE REDUCTIONS AND ENDING TRANSFER PAYMENTS

PROCEDURAL HISTORY

On April 5, 2001, Lakedale Telephone Company (Lakedale or the Company) filed a petition asking the Commission to authorize the Company to do two things in regard to the Extended Area Service routes linking its Waverly and Montrose exchanges with the toll-free metropolitan calling area:

(1) to stop making transfer payments to the other incumbent local exchange carriers serving exchanges within the metropolitan calling area; and

(2) to pass the cost savings through to Waverly and Montrose subscribers in the form of substantially lower monthly EAS rates.

On May 9, 2001, the Department of Commerce filed comments recommending that the Commission both grant the petition and reduce EAS rates for these two exchanges even further by recalculating one of their components – lost access revenues – on the basis of the current number of access lines.

On May 29, 2001, the Company filed reply comments opposing recalculating the rates on the basis of the current number of access lines.

On October 3, 2001, the petition came before the Commission. In addition to the Company and the Department, three incumbent local exchange carriers which receive transfer payments for the Waverly and Montrose EAS routes appeared: Qwest Corporation (Qwest), Sprint Minnesota (Sprint), and Citizens Telecommunications Company of Minnesota, Inc. (Citizens). All three opposed Lakedale's petition on grounds that transfer payments should be eliminated on a state-wide basis, after an industry-wide proceeding, not on an exchange-by-exchange basis.

FINDINGS AND CONCLUSIONS

I. Factual and Legal Background

Extended area service (EAS) is a service arrangement permitting neighboring telephone exchanges to become a single local calling area with toll-free calling. Until 1994, criteria for installing EAS and procedures for setting EAS rates were set by statute.[1] In 1994, the Legislature repealed the statute and directed the Commission to conduct a state-wide fact-finding and policy-making proceeding to re-evaluate EAS eligibility standards and ratemaking principles.[2]

At the end of that state-wide proceeding the Commission issued two Orders setting current EAS criteria and procedures.[3] With the exception of the traffic volume requirement – which the Commission raised from one call per customer per month to three calls per customer per month – the Commission determined that the former statutory requirements were fundamentally sound and essentially re-adopted them.

Briefly, the criteria and procedures established in those Orders are as follows:

(1) A petitioning exchange must be contiguous with the exchange or local calling area to which it seeks EAS.

(2) At least 50% of subscribers in the petitioning exchange must make at least three calls per month to the exchange or local calling area to which EAS is sought.

(3) The companies serving the affected exchanges or local calling areas must determine the cost of installing and operating the proposed EAS route and file proposed rate additives to recover these costs.

(4) The Commission must allocate between 50% and 75% of the total cost of the EAS route to the petitioning exchange. If the petition is for EAS to the metropolitan calling area, the Commission must allocate 75% of the total costs to the petitioning exchange.

(5) The Commission must set rates on the basis of cost information filed by the companies serving the exchanges and must poll subscribers in the petitioning exchange on whether they want EAS at those rates. If 50% of subscribers responding to the poll vote yes, the EAS route must be installed.

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[1] Minn. Stat. § 237.161.

[2] Laws 1994, c. 534, art. 1, § 1.

[3] In the Matter of an Investigation into the Appropriate Local Calling Scope, in Accordance with Minn. Stat. 237.161 (1994), Docket No. P-999/CI-94-296, ORDER REACTIVATING THE PROCESSING OF EAS PETITIONS (October 24, 1995) and ORDER AFTER RECONSIDERATION (February 23, 1996).

The Commission continues to apply these criteria and procedures to EAS petitions, with the exception of the cost allocation procedures set forth in the fourth item, which result in transfer payments.

The Commission has not applied these cost allocation procedures to pending EAS petitions since November 2000. In two cases decided that month, the Commission found that, while inter-exchange cost allocation was reasonable and equitable in a monopoly environment, it is so anti-competitive in its potential effects that it cannot be permitted in the current, competitive environment.[4] (The exception is School District EAS cases, where the Legislature has required inter-exchange cost-allocation to further overriding public policy goals.)

II. The Company's Proposal

Lakedale's Waverly and Montrose exchanges were added to the toll-free metropolitan calling area in April 1998. They were assigned 75% of total EAS costs under the cost allocation procedures then in place. Transfer payments from this cost allocation account for over 25% of Montrose's EAS rates and nearly 33% of Waverly's. Current EAS rates and the EAS rates that would go into effect if transfer payments were eliminated are set forth below:

Montrose

Service	Current Rate	Proposed Rate
Low-Cost Alternative	$ 7.35	$ 3.95
Flat Rate	$48.60	$35.66
Public Lines	$72.90	$53.49

Waverly

Service	Current Rate	Proposed Rate
Low-Cost Alternative	$ 7.35	$ 3.95
Flat Rate	$42.20	$28.28
Public Lines	$63.30	$42.42

III. Comments of the Parties

A. Department of Commerce

The Department of Commerce (the Department) supported eliminating transfer payments from these EAS rates, but the agency also urged the Commission to recalculate the EAS rates on the basis of the current number of access lines served.

[4] In the Matter of a Petition for Extended Area Service from the Almelund Exchange to the Metropolitan Calling Area, Docket No. P-407, 405, 413, 520, 426, 427, 430, 421/CP-97-1237, ORDER AFTER RECONSIDERATION (November 6, 2000), *reversed in part on the Commission's own motion as to other issues*; In the Matter of a Petition for Extended Area Service from the Osakis Exchange to the Alexandria Exchange, Docket No. 552, 430/CP-98-1148, ORDER ESTABLISHING RATE ADDITIVES AND REQUIRING FURTHER FILINGS (November 6, 2000), *reversed on reconsideration as to other issues.*

The Department pointed out that the number of access lines in both exchanges has grown significantly since these EAS rates were set. The agency claimed that applying these rates to a larger number of access lines resulted in the Company over-recovering its costs. Essentially, the Department recommended dividing the original cost of each route, minus the transfer payments, by the number of access lines currently served.

B. Qwest, Sprint, and Citizens

These incumbent local exchange carriers all receive transfer payments from Lakedale for the Waverly and Montrose EAS routes. While they supported eliminating transfer payments in principle, they opposed eliminating them in this case, on grounds that transfer payments were a systemic problem that should be addressed in an industry-wide, state-wide proceeding.

IV. Commission Action

The Commission will grant Lakedale's petition for the reasons set forth below.

A. Transfer Payments Removed as Anti-Competitive

First, it is clear that the transfer payments in this case pose significant risks to the development of the competitive telecommunications marketplace mandated by Congress and the Minnesota Legislature. As the Commission explained when it refused to permit transfer payments in the Almelund EAS case[5] —

> *The Commission has a duty and a commitment to nurture and promote competition in telecommunications. Both Congress and the Minnesota Legislature have found that the public interest requires transforming the telecommunications sector of the economy from the monopoly of the past to a fully functioning competitive market.[6] Allocating other exchanges' and other companies' EAS costs to the Almelund exchange is inconsistent with that public policy goal. It would undermine competition in at least three ways.*
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> *First, it would give incumbent carriers serving exchanges with EAS to Almelund a competitive advantage over new entrants seeking to serve those exchanges. Both incumbents and new entrants would be required to offer EAS service to Almelund. The incumbents, however, would have some of their costs offset by transfer payments from Almelund, while the new entrants would have to bear all the costs themselves. This would clearly place new entrants at a competitive disadvantage.*

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[5] In the Matter of a Petition for Extended Area Service from the Almelund Exchange to the Metropolitan Calling Area, Docket No. P-407, 405, 413, 520, 426, 427, 430, 421/CP-97-1237, ORDER AFTER RECONSIDERATION (November 6, 2000), *reversed in part on the Commission's own motion as to other issues.*

[6] Minn. Stat. §§ 237.011, 237.16; Pub. L. No. 104-104, 110 Stat. 56 (codified as amended in scattered sections of title 47, United States Code).

Second, it would give new entrants seeking to serve the Almelund exchange a competitive advantage over the incumbent carrier. Again, both the incumbent and new entrants would be required to offer Almelund/Metro EAS service. The incumbent, however, would have to cover both its own EAS costs and those allocated from other exchanges, while the new entrant would have to cover just its own costs. This would place the incumbent at a competitive disadvantage.

Third, it would work at cross purposes with the Commission's ongoing efforts to promote competition, by disrupting the cost/price relationship on which competition depends. Competition benefits consumers by driving price to cost and by driving cost to its most efficient level, as firms adopt operating efficiencies to compete more effectively. Much of the work required to move telecommunications from a monopoly environment to a competitive one lies in dealing with the subsidies that break this cost/price link.[7]

Allocating other companies' EAS costs to Almelund would complicate these efforts by creating additional subsidies that the Commission would have to undo at a later date.

Transfer payments as large as the ones in this case significantly distort the dynamics of a competitive marketplace and carry all the risks discussed above. The Commission therefore has a duty to eliminate them, as the Company requests.

B. Rates Not Recalculated to Reflect Increases in Access Lines

The Department supported eliminating transfer payments in this case, but also urged the Commission to recalculate the Waverly and Montrose EAS rates on the basis of the current number of access lines in each exchange. The Commission declines to do so.

As the Company points out, EAS rates (and, indeed, local rates in general) are set in the knowledge that they will be applied on a per-line basis and that the number of lines served may grow. Nevertheless, rates are not set subject to true-up or to recalculation at predetermined intervals, mainly because costs, too, grow in unpredictable ways.

Additional lines impose additional costs on the network, as do infrastructure improvements, inflation, and other factors. Therefore EAS rates, like other local rates, typically continue at their original levels until a company's overall rate levels are examined. The Commission sees no justification for departing from standard regulatory practice in this case.

C. Relief to These Individual Exchanges Permissible

Qwest, Sprint, and Citizens stated that they considered transfer payments anti-competitive and supported eliminating them in principle. They opposed eliminating them in this case, however – and presumably in any case not involving every EAS route in the state – on grounds that transfer payments were a state-wide problem that should be addressed in a state-wide proceeding.

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[7] Some examples of common, but not universal subsidies, are toll service/local service, high density service area/low density service area, business service/residential service.

While the Commission recognizes that transfer payments may be a problem in exchanges besides Waverly and Montrose, the Commission will not for that reason deny relief to Waverly and Montrose subscribers. Lakedale has filed a petition for relief to which the Company and its subscribers are entitled. Granting relief here will not hinder, delay, or prejudice any future claims for relief by other companies. Nor will it predetermine the procedural treatment of any such claims.

The Commission will therefore act on this petition despite the likely presence of similar issues in other exchanges.

D. New Rates Approved; Itemization Required in Tariffs

Finally, the Commission will require that the tariffs for Lakedale's Waverly and Montrose EAS rates separately itemize the portion of the EAS rate additive that recovers facilities costs and the portion that recovers lost access revenues. This information may be helpful in developing and implementing a universal service funding mechanism or in future rate re-balancing initiatives. To ease administration and prevent confusion, however, monthly bills should show only the total EAS rate.

The Commission will so order.

ORDER

1. The Commission grants the petition of Lakedale Telephone Company to eliminate transfer payments from its Waverly and Montrose EAS rate additives and approves the rates calculated and proposed by Lakedale, set forth below:

Montrose

Service	Current Rate	Proposed Rate
Low-Cost Alternative	$ 7.35	$ 3.95
Flat Rate	$48.60	$35.66
Public Lines	$72.90	$53.49

Waverly

Service	Current Rate	Proposed Rate
Low-Cost Alternative	$ 7.35	$ 3.95
Flat Rate	$42.20	$28.28
Public Lines	$63.30	$42.42

2. Lakedale's obligation to make transfer payments for these routes shall end as of the date the new EAS rate additives go into effect.

3. Within 30 days of the date of this Order, Lakedale shall file compliance rates with a proposed effective date.

4. Lakedale shall file a proposed customer notice for review by Commission staff.

5. The EAS rate additives approved herein shall be itemized in Lakedale's tariffs to show which portion of the rate additive will recover facilities costs and which portion will recover lost access revenues. The EAS rate additives shall not be itemized on customers' bills.

6. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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